

To: Barrett, Paul S [REDACTED]
From: Jeffrey Epstein [REDACTED]
Sent: Mon 10/22/2012 1:51:15 PM
Subject: Re: To Do - HY BOND IDEAs: EarthLink and Headwaters

ok

On Mon, Oct 22, 2012 at 9:36 AM, Barrett, Paul S <[REDACTED]> wrote:

Jeffrey

I think we should buy \$1MM each of the following bonds:

1. EarthLink 8.875% 2019 ytw 7.94%
2. Headwaters 7.625% 2019 ytw 6.70% - fits into our housing recovery theme

We have \$18MM in cash right now.

Let me know.

Paul

ELNK 8.875 05/15/19

Issuer: EARTHLINK INC
Ticker: ELNK
Ratings: B2/B-
Ranking: Senior Unsecured
Coupon: 8.875%

Maturity:	05/15/19
Call Schedule:	05/15/15 @ \$104.438 05/15/16 @ \$102.219 05/15/17 @ \$100
Price:	\$103.50
YTW:	7.94% (05/15/17 @ 100.00)
YTM:	8.17% (UST + 702bps)
OAS Mod Duration:	3.82
Issue Size:	300mm
Min Denom:	2k x 1k
Cusip:	270321AC6

Company Background

EarthLink, Inc. provides IT, network and communication services to individual and business consumers. The Company provides customers with managed IT services including cloud computing, data centers, virtualization, security ,applications and support services. EarthLink also offers nationwide data and voice IP services.

Key Points

- Strong credit metrics
 - 2.2x Gross leverage / 1.3x net leverage
 - Peers are 3-4x levered
 - 400mm in liquidity (260mm of which is in cash)
 - Good free cash flow
 - LTM FCF of 81mm
- Relative Value
 - WIN 7 3/15/19 (97381WAF1) – YTW(2015): 5.1% - *pick up 284bps*
 - CBB 8.375 10/15/20 (171871AN6) – YTW(2015): 6.5% - *pick up 144bps*

- JPM Single B High Yield Index: 6.31% - *pick up 163bps*
- JPM Telecommunications High Yield Index: 5.68% – *pick up 226bps*
- Good debt covenants
 - EarthLink cannot raise debt if leverage exceeds 3.75x
- Declining consumer side (specifically dial-up) is being addressed through pursuits of full IT solutions on the business side
 - This may cause higher leverage in the future but as mentioned above there is a limitation to leverage right now based on covenants
- Key catalyst for upside on these bonds: Refinancing of 10.5 ITC Deltacom notes
 - ITC Deltacom subsidiary represents ~31% of consolidated EBITDA and 36% of total assets
 - Right now, they cannot guarantee the 8.875 senior notes until its existing secured debt (ELNK 10.5 16) is refinanced
 - DB expects the call to happen in April 2013 as it seems they could refinance significantly cheaper

Risks: Greater than expected decline in EBITDA from One Communications or the dial-up business, as well as integration risk associated from future M&A deals we believe the company may be pursuing.

Source: www.earthlink.net, DB Research

HW 7.625 04/01/2019

Issuer:	HEADWATERS INC
Ticker:	HW
Ratings:	B2/B+
Ranking:	2 nd lien
Coupon:	7.625
Maturity:	04/01/2019

Call Schedule: 04/01/2015 @ \$103.813
 04/01/2016 @ \$101.906
 04/01/2017 @ \$100.000

Price: \$103.50

YTW: 6.70 % (04/01/2017 @ 100.00)

YTM: 6.94% (UST + 583bps)

OAS Mod Duration: 3.86

Issue Size: 400mm

Min Denom: 2k x 1k

Cusip: 42210PAQ5

Company Background

Headwaters Incorporated is a manufacturer of building products for new residential, residential remodeling, and commercial construction. Headwaters' portfolio of light building products includes architectural stone; resin-based exterior siding accessories, such as shutters, mounting blocks and gable vents; concrete block and brick; and other building products.

Key Points

- Three business segments: Light building Products (~51% of revenues), Heavy Construction Materials (47% of revenues), and Energy Technology (2% of revenues)
 - o % revenue based on Last Twelve Months
- Good credit metrics
 - o 3.9x Leverage through these notes
 - o 80mm in liquidity of which 30mm is cash
 - o DB estimates 30mm FCF next year
 - o Only other debt they have are subordinate convertible bonds
 - ~54mm due in 2014 and ~49mm due in 2016
- Good play on our housing recovery theme

- Relative value

- o JPM Single B High Yield Index: 6.31% - *pick up 39bps*
- o JPM Housing High Yield Index: 5.63% – *pick up 107bps*

Risks: Declines in new residential and nonresidential construction spending. Also, raw material price changes and the ability to pass those along could affect earnings. Finally an adverse ruling by the EPA classifying coal ash as a hazardous waste could result in concrete makers choosing to use less or no coal ash in their ready-mixed concrete, which would adversely affect HW's heavy construction materials segment.

Source: www.headwaters.com, DB Research

Paul Barrett, CFA

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